# The Studies of the National Monetary Commission

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THE National Monetary Commission had its origin in the financial and banking panic of 1907. That astonishing disturbance and collapse of credit was one of the most unbecoming, if not disgraceful, episodes in our financial history. Popular clamor followed. When the air had cleared it was seen that the trouble was due to the banking system, which, ill-adapted to supply the needs of a progressive industrial nation under normal conditions, was utterly inadequate for the preservation of business equilibrium and the allaying of distrust in times of business accident and unexpected strain.

Dissatisfaction with our banking system began, however, long before the panic of 1907. The banks received a share of the blame for the crises of 1873 and 1893, while during the ten years of intense business activity preceding the panic of 1907, banking reform was a question of almost constant public agitation. This was a period of rapid, indeed almost revolutionary, changes in industrial and commercial organization, but the development of banking seemed to lag behind, owing, it was believed, to the rigid character of the banking laws. The panic of 1907 brought the criticism of the banking system to a climax and the Congress which assembled in December of that year, some weeks after the outbreak of the panic, was flooded with bills designed to reform the monetary and banking systems of the country.

In this aroused state of public opinion some action by Congress was inevitable, but it was soon realized that widely divergent views as to what was needed to correct the evils of the existing situation, conflicting business interests and partisan political aims, would prevent the enactment of any thorough-going measure of reform. The leaders of the dominant party in Congress adopted, therefore, a temporizing policy and secured the passage of a law, commonly known as the Aldrich-Vreeland Act, approved May 30, 1908, providing for the issuance of emergency currency under certain conditions. This act was a makeshift measure and must be regarded as a political rather than a financial expedient. It was passed with but little debate and without previous consideration by the regularly constituted committee of either house of Congress. It was intended to satisfy the urgent public demand for action by Congress and to enable the party in power to say that provision had been made against a recurrence of the troubles that had afflicted the country in the preceding autumn.

## THE MONETARY COMMISSION AND ITS DUTIES

But the Aldrich-Vreeland Act also created the National Monetary Commission, to be composed of nine members from the Senate and nine from the House of Representatives, prescribed its authority and duties and made an appropriation to cover the necessary expenses of its work. The work of the Commission is clearly defined in Section 18 of the Act which provides:

> That it shall be the duty of this commission to inquire into and report to Congress at the earliest date practicable, what changes are necessary or desirable in

the monetary system of the United States or in the laws relating to banking and currency. The commission shall have the power, through subcommittee or otherwise, to examine witnesses and to make such investigations and examinations, in this or other countries, of the subjects committed to their charge as they shall deem necessary.

Within a short time after the passage of the law, the National Monetary Commission was organized with Senator Nelson W. Aldrich, of Rhode Island, as chairman and Congressman E. B. Vreeland, of New York, as vice-chairman. The Commission was a purely political body. The law restricted membership to senators and representatives in Congress. All sections of the country, including sixteen different states, were represented in its original composition. The members could hardly be regarded as experts or even students of banking and currency problems and only a few of them had had any legislative experience with such questions. The Commission was, therefore, forced to depend in large measure on outside help in making its inquiry and preparing its recommendations. Almost from the beginning, the work of the Commission was personally directed by Senator Aldrich and was continued for a period of more than three years with some considerable intervals of inactivity.

In order to make the inquiry required by the law and bring together the information that would be needed in formulating legislative proposals, the Commission employed a number of prominent economists, financial editors, bankers and government officials in the United States and foreign countries to prepare monographs, papers and reports on the actual operations of banks and on their separate functions and mutual relations. Members of the Commission visited the leading countries of Europe whose economic conditions were most nearly like our own, and appointed representatives to visit other countries for the purpose of holding personal interviews with the officials of leading institutions concerning their banking organization and their arrangements for dealing with reserves, note issues, commercial paper and other banking problems. The Commission also conducted hearings and made inquiries in different parts of the United States and particularly in a dozen or more of the leading commercial centers of the country for the purpose of getting the opinions of people in different localities and occupations on desirable changes in our banking laws. The discussion of currency and banking problems in the meetings of various learned societies and associations of business men and bankers were also utilized by the Commission as a means of securing expert opinions.

## PUBLICATIONS OF THE MONETARY COMMISSION

The results of the studies and investigations carried on by people enlisted in the service of the Commission, and of its own interviews, public hearings and inquiries, together with the report and bill submitted to Congress by the Commission at the conclusion of its work, have been issued as public documents in a series of twenty-three volumes under the general title of *Publications of the National Monetary Commission.* The material in these volumes covers about 14,000 octavo pages and about 1,200 quarto pages, the latter containing chiefly statistical matter. Of the total of over 15,000 pages, about two-thirds, or more than 9,000 pages, deals with banking and related problems in foreign countries. Of the whole mass of information brought together in the

publications only a relatively small part is entirely new. Some of the material included is simply a reprint of previous publications, and a large part of the matter dealing with American conditions consists of books, monographs and reports previously published but revised and brought up to date and republished for the uses of the Commission.

Some of these revisions were, however, of vital importance to the completion of the investigation which the commission had undertaken. This was especially true of the two monographs by Dr. David Kinley on "The Independent Treasury of the United States and its Relations to the Banks of the Country" and "The Use of Credit Instruments in Payments in the United States." The study of Treasury operations left no doubt concerning the need of some new and efficient machinery for handling the government's financial business, while the investigation of the use of credit instruments fixed attention on the tremendously important function of the deposit currency as a means of employing bank credit in the transaction of the business of the country.

### VALUABLE CONTRIBUTIONS

Among the most notable of the new contributions to the study of American conditions were the "Seasonal Variations in the Relative Demand for Money and Capital in the United States" by Professor E. W. Kemmerer and the "History of Crises under the National Banking System" by Professor O. M. W. Sprague. The volume by Professor Kemmerer is an elaborate statistical study based on a mass of financial data, such as statements of condition of banks, clearing house returns, movements of money, rates of exchange, monetary circulation, bond prices, etc. The study was not confined to the New York money market alone, but included also the markets of Chicago, St. Louis, New Orleans and San Francisco, to the extent that information was available. While Professor Kemmerer's investigation was the most complete of any ever made in this field, it did not result in any modification of accepted theories of seasonal and other periodic market movements but served rather to confirm them.

Professor Sprague's volume of 484 pages on "The History of Crises under the National Banking System" is an important contribution to our financial literature and the most valuable of the original studies made for the Monetary Commission. It is a careful, critical examination of the results of banking policy and management as developed under the National Bank Act in all the periods of crisis from 1873 to 1907. Professor Sprague describes the nature of the problems that presented themselves from time to time and compares the success of the methods that were evolved to meet them. His final judgment is that "it is impossible to escape the depressing conclusion that the banking situation in 1907 was handled less skilfully and boldly than in 1893, and far less so than in 1873. No new elements of weakness were disclosed, but no real effort was made to overcome difficulties which had been met, with partial success at least, on former occasions." The most important lesson to be drawn from Professor Sprague's study is that banking reform would prove most certain and successful if pursued along the line of the means naturally evolved by our bankers for meeting their problems.

Such an inference is in accordance with our best experience. Probably the most successful banking system we have had in this country was the Suffolk system of the New England

states in the period before the Civil War. This was a plan of banking developed by bankers, slightly aided from time to time in their efforts by the law, to insure efficiency and safety in the employment of bank credit on a basis of circulating notes. If bankers since the Civil War had been free to act in accordance with their experience, and had been reasonably supported by the law, there is no reason to suppose that they could not have developed for the whole country equally efficient and successful methods of insuring safety in the use of bank credit based on deposit currency.

## INVESTIGATION OF FOREIGN BANKING SYSTEMS

In the investigation of foreign banking and currency conditions, much more attention was given to England, France and Germany because it was believed that business conditions in these countries were more nearly like our own. Of the 9,000 pages in the publications devoted to material relating to foreign countries, over 6,500 deal with conditions in these three countries alone, and of these pages about 4,500 relate exclusively to Germany. It was the opinion of Senator Aldrich, as well as of some other members of the Commission, that the banking system of Germany was of more interest than any other to the people of the United States because the industrial and commercial interests of the German Empire were very largely of the same character as our own. This German material, like that relating to the United States, consists largely of reprints in English translation of books, reports and papers previously published in German. These reprints include the memorial history of "The Reichsbank, 1876–1900," the "German Imperial Banking Laws," the third German edition of Dr. Jacob Riesser's "The German Great Banks and their Concentration in Connection with the Economic Development of Germany," almost the entire report and proceedings of the "German Bank Inquiry Commission of 1908," a series of articles from the *Frankfürter Zeitung* relating to "The Renewal of the Reichsbank Charter" and a series of "Miscellaneous Articles on German Banking" extracted mainly from the proceedings of the Third German Bankers' Convention. But in spite of the large amount of space given to German material, the publications of the Commission contain no general review of German banking as a whole, an omission which can only be regarded as a defect in the work of the Commission since so much importance was attached to German conditions and experience.

The information relating to English and French conditions is much briefer but also more useful in making a comparative study of American experience. The monographs by Hartley Withers on "The English Banking System" and by R. H. I. Palgrave on the "History of the Separation of the Departments of the Bank of England" are the best of the publications relating to England. Mr. Withers' statement is an illuminating account of the complicated relations of the Bank of England, the joint-stock and private banks, and the accepting houses and discount houses, and the position of all of them in the market.

The most valuable of the publications dealing with French conditions are the "Evolution of Credit and Banks in France from the Founding of the Bank of France to the Present Time" by André Liesse and "The Bank of France in its Relation to National and International Credit."

Some of the best information concerning the operation of the foreign banking systems, and particularly those

of England, France and Germany, is to be found in the reports of the interviews held in the summer of 1908. The replies to questions put to bank officials in these interviews, with respect both to what they said and what they left unsaid, often throw more light on some aspects of the actual working of the foreign systems than anything else published by the Commission. But the information contained in these reports is not so accessible because no attempt was made to analyze and digest it in a systematic manner.

### DISCLOSURES AS THE RESULT OF CONTRASTING BANKING SYSTEMS

The things which this extended study of foreign banking conditions emphasizes in contrast with American conditions are:

1. The existence in each country of a central institution, more or less closely related to the government of the country, which serves not only as a government bank but also as a banker's bank and as a bank for the public.

2. The centralization and control of note issue by means of these institutions.

3. The high degree of centralization in general administration and management of reserves in all countries.

The publication of this mass of material relating to foreign banking was one of the most useful services that the National Monetary Commission performed. It made available for our political leaders, banking and financial journalists and the general public, a vast fund of information on banking organization and operation in foreign countries which was formerly known only to expert students of the subject.

It is not easy to estimate the influence which the studies carried on under the direction of the National Monetary Commission had in shaping its conclusions concerning the defects of our banking system and in devising the necessary measures of reform which were finally submitted to Congress in the form of a report and a bill at the beginning of 1912, three and one-half years after the initiation of the Commission's work. A large portion of the publications of the Commission were issued in 1910 before anything definite was known of the plan of reform to be recommended. In January, 1911, Senator Aldrich personally gave out what he described as a "suggested plan of monetary legislation."

In substance this plan was an elaborate central bank scheme to be owned and controlled by the banks of the country with due representation of the government on its official board. This suggested plan does not seem to have been the product of any deliberations of the National Monetary Commission itself, based on the results of the scientific inquiry it had been conducting. No formal meetings of the Commission as an official body were held before the fall of 1911 when a resolution calling for a report from the National Monetary Commission on January 8, following, was introduced in Congress by Senator Cummins of Iowa and adopted.

Although due allowance must be made for the influence of American opinion and European experience, the suggested plan was probably the work of Senator Aldrich, aided by the advice of a few experienced men, among whom Mr. Paul M. Warburg, the New York banker, is commonly reputed to have played an influential part. The proposals made in this plan, which soon came to be spoken of as the Aldrich Plan, were fully discussed for several months in meetings of bankers and business men and in economic,

banking and financial periodicals and newspapers. In October, 1911, the plan was revised and redrafted in the form of a bill and included in the report submitted to Congress on January 8, 1912, as the recommendation of the National Monetary Commission.

## DEFECTS IN THE UNITED STATES BANKING SYSTEM

The defects in our banking system which are elaborately summarized in the report of the Commission may, for the purposes of this paper, be briefly recapitulated as follows:

1. The existing banking system provides no effective means for coöperation by banks in crises.

2. It admits of no concentration of the banking reserves of the country for use in times of stringency or unusual strain.

3. The banknote circulation fails to respond, through automatic expansion and contraction, to changing needs of business.

4. The existing system provides no effective agency for facilitating exchanges and transfers of funds between different localities and sections of the country.

5. It affords no means of properly regulating the foreign exchanges and controlling the international flow of gold.

6. Interior communities do not have the benefits of ready access to the central money markets.

7. Existing arrangements lead to the congestion of banking resources in large financial centers stimulating speculation when they are accumulating and unsettling the market when they are withdrawn.

8. The accumulation of government funds in other institutions than the banks results in constant disturbance of bank reserves and further unsettling of the market.

To rectify these evils, the bill recommended by the Commission proposed to incorporate the National Reserve Association of the United States, with a capital of $100,000,000 to be subscribed voluntarily by national banks, and also by state banks and trust companies under certain conditions. Subscribing banks in contiguous territory were to be grouped in local associations, while these local associations were to be combined into fifteen district associations covering the entire territory of the United States and serving as branches of the National Association. The central association thus organized was to have authority:

1. To take over the note issuing function of the national banks, basing such note issues ultimately on legal money and first class commercial paper instead of bonds, and further, to have the privilege of issuing additional notes, having the same security, on payment of a graduated tax thereon.

2. To rediscount for national banks first class commercial paper maturing in short periods of time.

3. To transfer funds for national banks between the central association and the branches, and between the branches.

4. To receive and hold deposits of subscribing banks and the government, but no private deposits.

To insure safety in reserve management the National Association was required to hold a cash reserve equal to fifty per cent of its demand liabilities. It was also provided that the association should serve as a depository for public funds and as the fiscal agent of the Federal government. No changes were made in the reserve requirements of national banks except that they could count the notes of the central association as well as their deposits with it as reserves.

Probably no economic measure ever

brought before the Congress of the United States received at the hands of political leaders, students of banking and currency problems, and the general public, such comprehensive study and thorough discussion as this one, but in spite of the great amount of time and labor spent on it and the heavy expense incurred, it had no direct consequences whatever in the way of constructive legislation.

### POLITICAL CHANGE AND THE ALDRICH PLAN

By the beginning of 1912 the political situation had completely changed and the recommendations of the Monetary Commission were never brought up in Congress for consideration. Many of the men who had been members of the Commission when it was organized had either retired from public life or had been retired in the elections of 1910. During the discussion of Senator Aldrich's suggested plan, which preceded the formal submission of the Commission's findings and recommendations, much opposition of a general character developed against it, not apparently because of any lack of confidence in the soundness of the measures proposed, but because of a general distrust of the men who were primarily responsible for it, particularly of Senator Aldrich who, as chairman, had controlled and directed all the activities of the Commission. Whether or not it was warranted, there was a widespread belief in the country that Senator Aldrich was too close to some of the great business interests whose purposes, it was believed, were not always in harmony with the highest public welfare. In view of this attitude of the public it was not unnatural that the new party leaders in Congress should decline to look for guidance in the work and findings of the National Monetary Commission.

### THE RESERVE ACT AND THE MONETARY COMMISSION'S WORK

The extent to which the framers of the Federal Reserve Act drew upon the work of the National Monetary Commission has been a matter of some interest. At the time the Act was under discussion many people regarded it as nothing but a copy in large part of the Aldrich Plan, but there were no substantial grounds for such a claim, although the two projects were similar in many of their fundamental provisions. In describing the legislative history of the Federal Reserve Act some months after its passage, Dr. H. Parker Willis, who was the expert of the House Banking Currency Committee while the bill was being drafted, makes the following statement concerning its origin:[1]

> The Federal Reserve Act is the product of a lengthy course of development and has grown gradually out of the discussion and analysis of the past twenty years. It is not drawn, even largely, from any single source, but is the product of comparisons, selection and refinement upon the various materials, ideas and data, rendered available throughout a long course of study and agitation. Many bills embodying the same general line of thought that now finds expression in the new act have been offered in Congress.

All of this might be said also, with equal truth, of the Aldrich Plan itself. Certain it is, that the fundamental principles underlying the essential provisions of both measures were well established in European and American banking theory.

The investigations of the National Monetary Commission were limited to the field of banking and bank currency although the scope of the instructions given the Commission by the law would have permitted a wider range

[1] *American Economic Review*, Vol. IV, *p.* 13.

of activities. Many students thought at the time that it was a good opportunity to amend some of the other serious defects in our monetary system. Since the beginning of the Civil War, our money had become the most heterogeneous and complex of any in use by the great nations of the world. Besides the gold basis, it included several different types of fiduciary money in large amounts with complicated machinery for maintaining them at a parity with the standard. A general reform of our banking system and bank currency was regarded by many as furnishing the best opportunity to secure a final solution of the greenback and silver questions, but the National Monetary Commission avoided these issues as did also the framers of the Federal Reserve Act.

### Currency Complexities Persist

Today, it is a serious question whether or not the addition of the Federal Reserve notes to our monetary circulation, without any material change in the amount of national bank notes or the other forms of fiduciary money in use, has not increased the complexity and difficulties of our monetary system without improving its efficiency as an instrument of economic welfare.

Between 1913 and 1920 the United States passed through a period of inflation that exceeded in its extent anything in our previous history. Some of this was due to our large acquisitions of new gold, but far more of it was due to the release of gold from bank reserves, made possible by the issue of Federal Reserve notes when the reserve requirements under the Federal Reserve Act were changed to their present form by the amendment of June, 1917. After this change in the law, expressions of gratification over the great economy of money that would be effected thereby were very common. But it is a strange economy of money that results in inflation! When the history of some of the provisions of the Federal Reserve Act and its amendments comes to be written, the judgment will be that they were inflationist legislation and that their enactment added still others to a long list of monetary errors into which the country has fallen.

### Some Unlearned Lessons

While the National Monetary Commission devoted a large amount of attention to the organization and working of the foreign banking systems, it neglected some aspects of those systems, a better understanding of which might have led to a clearer conception of the true defects of our own systems and of the best means of correcting them. Perhaps the most significant feature of the great foreign systems, according to the studies of the Commission, is the high degree of centralization that exists in control and management. But while the influence of the great central institutions in securing this centralization is strongly emphasized, no emphasis is laid on the effect of extreme concentration in foreign banking due to the widely extended system of branches. A relatively few great companies or corporations, including the central banks, control the business of banking in England, France and Germany. This control is exercised from central offices, usually located in the financial center of the country. This is an important, distinguishing feature of European banking as compared with our own.

In the United States much praise has been conferred on the Canadian banking system, but the chief difference between it and our own lies in the fact that Canada has relatively few

banking corporations with many branches widely scattered. Between 1900 and 1912 about 15,000 new banks were organized in the Unites States. This meant 15,000 new boards of directors and probably as many new conceptions of what constitutes sound bank policy and management. The existence of our vast number of independent institutions needs only to be mentioned to make it clear that no scheme of coöperation among banks yet devised in this country will give the degree of centralization in control and management that has been attained under the foreign branch systems.

### SUCCESSFUL BANKING PRIMARILY A QUESTION OF ADMINISTRATION

Another aspect of this subject is also of vital importance. If there is any one lesson that the study of European experience enforces, it is that successful banking is more a question of administration than of law. As Hartley Withers says, "Good banking is produced, not by good laws, but by good bankers." An important consequence of the extreme concentration in foreign banking is that it brings the best banking talent into positions of responsibility and control. No doubt our best bankers are the equals of the best European bankers but our type of banking does not bring them into positions where they can exercise complete control over the banking business of the country.

The apparent control of the flow of credit in the leading European countries through the manipulation of the discount rates of the central banks, is another feature of foreign banking which has always been in sharp contrast with our own practice and which we have tried to imitate in our banking reform. The studies of the Monetary Commission furnish no satisfactory explanation of the true nature of this control and how it is exercised. The impression is often gained that the bank rate determines the market rate, but it would probably be just as true to say that the market rate determines the bank rate. When Lord Avebury, partner of Robarts, Lubbock and Company, was asked concerning the extent to which the bank rate governed their loan and discount transactions, he replied, "The bank rate generally is an expression of the market rate." The truth is that the market rate is a competitive rate in the determination of which the competition, actual or potential, of the Bank of England with the other banks is always a factor.

### INFLUENCE OF BANKING COMPETITION

The influence of competition is more clearly seen in the operation of the French system than in that of England. In replying to a direct question concerning the competition of the Bank of France with the other banks, M. Pallain, the governor of the Bank of France, said, "On certain points there may be competition, and it is on account of this salutary competition that wherever a branch of the Bank has been established the rate of discount has been perceptibly reduced, in the interest of commerce."

The fact is that the control of the flow of credit in these countries is a competitive one. The central banks are not only bankers' banks and government banks; they are also public banks and compete with the other great centralized institutions for a share of the banking business of the country. Their relations to their governments, their prestige, and the fact that their managers think not only of profits but of the national economic welfare, places them in a strong competitive position and enables them to exercise

an influence much out of proportion to the amount of business they do.

There has been much discussion recently of the discount policy of the Federal Reserve Board and the control of the flow of credit under the Federal Reserve System. The charges of banks to their customers have not been materially affected by the manipulation of the rediscount rates. The explanation is that the Federal Reserve Banks are banks for banks and banks for government and not, at the same time, public banks in the true sense of the word. They cannot exert the competitive influence against the other banks that the foreign central banks exert. They are not in fact in the market and cannot, in consequence, share in market control.

# The National Citizens' League

## A Movement for a Sound Banking System

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AS a result of the panic of 1907 the business men of the country became greatly concerned for the commercial safety of the future. At the annual meeting of the National Board of Trade, held in Washington on January 25, 26 and 27, 1910, the subject of monetary reform was discussed and the following resolutions were unanimously adopted:

Whereas, We assume that a plan for the revision of our currency system will be formulated after the National Monetary Commission has made its final report; and

Whereas, A revision of our currency system upon a permanently sound and scientific basis is of vital importance to all interests and should be accomplished as soon as practicable;

*Resolved,* That the National Board of Trade favors the adoption of a currency system which will be based upon the following fundamental principles and insure the following results:

First—Be absolutely fair to all interests and to all localities;

Second—Insure at all times an adequate supply of properly safeguarded currency;

Third—The volume of said currency to automatically expand and contract in response to the normal demands of the manufacturing, commercial, agricultural, and other legitimate interests of the country;

Fourth—Said system to be absolutely free from domination or control by political or any other favored interests;

*Resolved,* That the National Board of Trade calls upon all its constituent bodies to carefully study the fundamental principles of banking and currency, in order to intelligently aid the enactment of such legislation as will best conserve the interests of the entire country.

The National Board of Trade determined to devote one day in connection with its annual meeting in 1911 to a Business Men's Monetary Conference. January 18 was set aside as "Monetary Day." Two hundred selected commercial bodies were to appoint special committees to make a careful study of the banking question. Each organization was requested to submit its conclusions and recommendations to the National Board of Trade at least one month before the meeting and to send a representative to the meeting, to be held in Washington beginning January 17, 1911. The invitation met with a hearty response on the part of the commercial organizations throughout the country and a large number